

STATE OF CALIFORNIA
DEPARTMENT OF WATER RESOURCES

RECONSIDERATION
OF AUGUST 16, 2002 JUST AND REASONABLE DETERMINATION
California Code of Regulations Title 23, Section 516 (b)



August 19, 2004

I. Introduction and Background

On February 1, 2001, Assembly Bill 1 from the First Extraordinary Session of 2001-2002 (AB 1X) was signed into law.¹ AB 1X authorizes the California Department of Water Resources (“the Department” or “DWR”) to purchase electric power to sell directly to retail end-use customers in the investor owned utilities’ service territories. This legislation was necessary because of the temporary inability of investor owned utilities such as Pacific Gas & Electric Company (“PG&E”) to buy the power needed to serve their own customers. AB 1X also authorizes the Department to enter into an “agreement with respect to charges” with the California Public Utilities Commission (“the Commission” or “CPUC”). On March 8, 2002, the Department and the Commission entered into the Rate Agreement.² Both AB 1X and the Rate Agreement require the Department to calculate its revenue requirements at least annually and submit them to the Commission. AB 1X authorizes the Department to issue bonds to pay costs resulting from the Department’s power purchase program. AB 1X also authorizes the Department to promulgate regulations for purposes of its power supply program as emergency regulations.

The Department promulgated emergency regulations for purposes of establishing a process to reach a determination of its revenue requirements as well as to examine whether its

¹ California Water Code Sections 80000 *et seq.*

² Rate Agreement between State of California Department of Water Resources and State of California Public Utilities Commission dated March 8, 2002 (Sacramento Superior Court Case No. 02CS01631; Index of Record of 2003 Revenue Requirement Reasonableness Determination (“DWR II”) 02914-02934).

revenue requirements are just and reasonable. (See, California Code of Regulations, Title 23, Sections 510–517 (the “Regulations”).) On June 7, 2002, the Water Commission approved the Regulations. The State’s Office of Administrative Law also approved the Regulations.³

On August 16, 2002, pursuant to AB 1X and the Regulations, the Department issued its Determination of Revenue Requirements for the period January 1, 2003 through December 31, 2003 with Reexamination and Redetermination for the period January 17, 2001 through December 31, 2002 (the “August 16, 2002 Determination”). The Department determined that the August 16, 2002 Determination was just and reasonable. On August 19, 2002 the Department advised and notified the Commission of its revenue requirements pursuant to Water Code Sections 80110 and 80134 and the Rate Agreement. On August 26, 2002, Southern California Edison Company (“SCE”) and PG&E submitted requests for reconsideration of the August 16, 2002 Determination. On October 8, 2002, the Department issued a written response, denying the requests for reconsideration.

On October 17, 2002, PG&E filed a verified petition for a writ of mandate in Sacramento County Superior Court. PG&E’s petition requested, among other things, a writ of mandate directing DWR to vacate its determination that its revenue requirements were just and reasonable and to comply with the California Administrative Procedure Act and any other applicable statute or regulation. On December 26, 2003, the Court issued a ruling in response to PG&E’s petition,

³ Since the approval of the Regulations, the California Court of Appeal for the Third District ruled that DWR is not required to hold a hearing pursuant to the California Administrative Procedures Act or California Public Utilities Code in determining whether its revenue requirements are just and reasonable under Section 80110 of the Water Code. 112 Cal. App. 4th 477, 501-502.

which determined that DWR had abused its discretion by failing to comply with its own regulations in making its just and reasonable determination of August 16, 2002. On January 27, 2004, a peremptory writ of mandate was issued requiring DWR to: (1) set aside the August 16, 2002 just and reasonable determination; (2) reconsider its just and reasonable determination in accordance with the Court's December 26, 2003 Ruling; and (3) conduct further proceedings in accordance with California Code of Regulations Title 23 Section 510 et seq. On May 20, 2004, DWR issued a Notice of Reconsideration of its Just and Reasonable Determination of August 16, 2002 for all of the periods covered thereby. A copy of DWR's Notice is attached hereto as Exhibit 1. Consistent with its Regulations, DWR provided all interested persons twenty-one (21) days to submit comments. On June 11, 2004, PG&E submitted comments in response to the Department's Notice of Reconsideration. No other comments were received by DWR.

The Department has reconsidered its just and reasonable determination in light of the Ruling of the Sacramento Superior Court dated December 26, 2003 and the entire administrative record developed in connection with the August 16, 2002 Determination, as well as the comments received from PG&E during this administrative reconsideration process. Based on this record, DWR hereby determines that its revenue requirements as set forth in the August 16, 2002 Determination are just and reasonable for all of the periods covered thereby.

II. PG&E Comments and Request for Relief

In its comments, PG&E requests that DWR determine that the costs which the State of California has challenged at the Federal Energy Regulatory Commission ("FERC") are not just and reasonable under Section 80110 of the Water Code and are therefore not recoverable in retail electric charges to DWR's customers. PG&E also requests that DWR adopt a remedy for past

and future overcharges to customers that requires power suppliers to reduce their prices to “just and reasonable” levels. In support of its comments, PG&E requests that DWR consider all of PG&E’s prior comments, pleadings and declarations submitted or filed either in DWR’s administrative processes considering its revenue requirements or Sacramento Superior Court Case Nos. 01CS01200 and 02CS01631. PG&E also attaches the Declaration of Eugene T. Meehan dated June 10, 2004 in support of its comments.

III. General Response

DWR appreciates PG&E’s comments regarding the need to conduct a just and reasonable review of DWR’s costs pursuant to Section 80110 of the Water Code as well as PG&E’s support for DWR’s efforts to renegotiate contracts with power suppliers. DWR’s reconsideration of the just and reasonableness of its revenue requirements demands that DWR adhere to the Peremptory Writ of the Sacramento Superior Court as well as the Department’s Regulations. The Regulations provide for a just and reasonable review based upon a specific standard.⁴

DWR emphasizes that its just and reasonable review is limited to the relevant time periods.⁵ Moreover, the information to be assessed in that determination concerns whether the revenue requirements were just and reasonable in light of the circumstances faced by the

⁴ 23 California Code of Regulations, Section 517. This just and reasonable reconsideration is based on the entire record in the public review process relevant to the August 16, 2002 Determination, including documents subject to applicable nondisclosure requirements, and not solely on the statements made or documents referenced in this document. Failure to specifically reference, in this document, materials in the record should not be interpreted to mean that the Department did not rely on those materials and incorporate such review in issuing this Reconsideration.

⁵ In its comments, PG&E asserts that DWR’s contracts will impose above market costs on ratepayers between 2004 and 2013. The August 16, 2002 Determination of Revenue Requirements addressed the Department’s revenue requirements for 2003 and a reexamination and re-determination of revenue requirements for 2001-2002.

Department at the time the various decisions implementing the power purchase program were made.⁶ To the extent that PG&E's prior comments, pleadings, or declarations were part of the administrative record on August 16, 2002, DWR has considered those documents. To the extent that PG&E's June 11, 2004 comments relate to facts and circumstances existing as of and before August 16, 2002 (including the California State Auditor's view, to the extent that view was based solely on those facts and circumstances), the Department has considered those specific comments.

IV. Specific Response to Declaration of Eugene T. Meehan dated June 10, 2004

A. Section 80110 of the Water Code and the Regulations Govern DWR's Just and Reasonable Review

In his Declaration supporting PG&E's comments, Meehan argues that the regulatory precedent for just and reasonable determinations is well established.⁷ Meehan states that "in order for a cost to be part of a just and reasonable revenue requirement, that cost must be prudently incurred."⁸ Meehan argues that standards applied by the CPUC to utilities in connection with the CPUC's just and reasonable review should apply to DWR. As previously explained in DWR's August 16, 2002 Determination, DWR does not believe that the Legislature intended that the Department conduct an after-the-fact reasonableness review and apply the same standard that has been traditionally applied by the Commission to utilities. DWR is not an

⁶ 23 California Code of Regulations Section 517.

⁷ Declaration of Eugene T. Meehan (hereinafter "Meehan Declaration") at pp. 2:14-4:15.

⁸ *Id.* at p. 2:20-21.

investor owned utility seeking to make a profit. By law, the Department is not permitted to realize a profit from its activities, nor does it have any shareholder capital from which to pay for costs that cannot be included in rates or charges. Any just and reasonable review and determination must be consistent with the mandate of Section 80134 of the Water Code that the Department establish and revise revenue requirements sufficient, together with other moneys, to provide for all of the Department's costs. These distinctions are so fundamental that Commission decisions on what just and reasonable means are unlikely to provide definitive guidance.⁹ The Department's Regulations require the application of the following standard in determining whether its revenue requirements are just and reasonable:

To protect ratepayer interests, the record of the determination must demonstrate by substantial evidence that the revenue requirement is just and reasonable, considering the circumstances existing or projected to exist at the respective times of the department's decisions concerning whether to incur the costs comprising such revenue requirement, and the factors which under the Act [AB 1X] are relevant to such determination and such decisions, including but not limited to the following:

(1) The development and operation of the program as provided in the Act is in all respects for the welfare and the benefit of the people of the state, to protect the public peace, health, and safety, and constitutes an essential governmental purpose;

⁹ DWR notes that the Commission decisions generally rely on a "prudent person" standard – that is, whether the costs would have been incurred by a prudent person under the circumstances existing at the time the decision to incur the costs was made. The Department considers this type of review to be an ongoing responsibility of its managers, in all programs, and in fact is a fundamental tenet of public administration. The Department did in fact examine the just and reasonableness of its August 16, 2002 Determination pursuant to a prudent person standard. *See*, August 16, 2002 Determination at p. 54. However, the prudency analysis undertaken by DWR is not identical to a prudency analysis undertaken by the Commission because of the nature of DWR as a public entity as well as the requirements of AB 1X and the Regulations.

(2) The department must do those things necessary and authorized under chapter 2 of the Act to make power available directly or indirectly to electric consumers in California; provided that except as otherwise stated, nothing in the Act authorizes the department to take ownership of the transmission, generation, or distribution assets of any electrical corporation in the State of California;

(3) Upon those terms, limitations, and conditions as it prescribes, the department may contract with any person, local publicly owned electric utility, or other entity for the purchase of power on such terms and for such periods as the department determines and at such prices the department deems appropriate taking into account all of the factors listed in section 80100 of the Water Code;

(4) The department may sell any power acquired by the department pursuant to the Act to retail end use customers, and to local publicly owned electric utilities, at not more than the department's acquisition costs, including transmission, scheduling, and other related costs, plus other costs as provided in section 80200 of the Water Code;

(5) The department must, at least annually, and more frequently as required, establish and revise revenue requirements sufficient, together with any moneys on deposit in the Electric Power Fund, to provide for all of the amounts listed in section 80134(a) of the Water Code, including but not limited to the repayment to the General Fund of appropriations made to the Electric Power Fund for purposes of the Act; and

(6) Obligations of the department authorized by the Act shall be payable solely from the Electric Power Fund.¹⁰

Pursuant to Court's Peremptory Writ and the Regulations, the Department must rely on the standards set forth above to determine whether the August 16, 2002 Determination is just and reasonable. The various factors set forth in the above standards in large part mirror the statutory directives of AB 1X. These directives were part of the circumstances facing the Department at

¹⁰ 23 California Code of Regulations § 517.

the time when it made various procurement decisions underlying the August 16, 2002 Determination.

B. The Record Contains Substantial Evidence to Support a Just and Reasonable Determination

(i). Comparison to Market

In his Declaration, Meehan argues that the administrative record in this proceeding fails to demonstrate that many of DWR's power purchases were prudent. Specifically, Meehan asserts that the record fails to contain any comparison of DWR's energy contracts with contemporaneous forward markets for similar energy contracts.¹¹ However, Meehan acknowledges that the record does contain evidence that DWR relied on broker services that provided forward market price curves extending out as far as five years.¹² Meehan's criticism appears to be that DWR has not included the actual forward price quotations in the administrative record.¹³ The Declaration of Susan Lee dated August 9, 2002, which is included within the administrative record, provides substantial evidence that DWR did rely on forward market price curves and forward price quotations while assessing procurement options.¹⁴ Moreover, there is other evidence in the administrative record to reflect that DWR examined

¹¹ *Id.* at p. 6:26-27.

¹² *Id.* at p. 7:25-8:2. *See also*, Declaration of Susan Lee dated August 9, 2002 at paragraphs 11 and 13 (DWR II 05605-05611); Declaration of Ronald O. Nichols dated August 8, 2004 at paragraphs 76-77 (DWR II 05612-05640) and Exhibits 40-41 thereto — *History of DWR's Net Short Energy Procurement Process Under Long-Term Contract* (DWR II 06221-06227).

¹³ Meehan Declaration at p. 8:3-9.

¹⁴ Declaration of Susan Lee dated August 9, 2002 at paragraphs 11 through 19 (DWR II 05605-05611).

forward markets as well as a range of other assumptions and contingencies in its contracting efforts.¹⁵ PG&E has provided no evidence to refute the fact that DWR relied on forward market price curves in reaching its procurement decisions.

Importantly, a comparison to market price is not the sole consideration with respect to whether DWR's energy costs are just and reasonable under AB 1X. The Legislature intended that the Department's power supply program achieve an overall portfolio of contracts for energy resulting in *reliable service at the lowest possible price*.¹⁶ The Department's objectives were to meet this two-part directive: reliability and cost-effectiveness. Accordingly, the Department's core strategy was to emphasize longer-term contracts as a means to secure new generation capacity for greater reliability and long-term price stability. This strategy underwent periodic review and modification as the program progressed and market conditions changed.¹⁷ DWR's long-term power purchase contracts must be assessed in part based on whether they contributed to the achievement of the goal of increased reliability at lower prices, by shifting supply from the spot market to a long-term supply.¹⁸

¹⁵ See generally, Declaration of Ronald O. Nichols dated August 8, 2002 at paragraphs 5 through 43 (DWR II 05612-05640).

¹⁶ Water Code Section 80100 (a).

¹⁷ See, Declaration of Ronald O. Nichols dated August 8, 2002 at paragraphs 38 through 88 (DWR II 05612-05640). See also, Declaration of Peter S. Garriss dated August 9, 2002 (DWR II 05588-0598).

¹⁸ See, footnotes 19-21, *infra*.

(ii). Present-Value Analysis

In his Declaration, Meehan states that he has not located evidence of present-value analysis in the administrative record supporting either the Department's long-term contracts or renegotiations of those contracts. The presence or absence of any present-value analysis in the administrative record does not determine whether the August 16, 2002 Determination is just and reasonable. Pursuant to the Regulations, "the record of the determination must demonstrate by substantial evidence that the revenue requirement is just and reasonable considering the circumstances existing or projected to exist at the respective times of the department's decisions concerning whether to incur the costs. . . ." There is substantial evidence in the administrative record which explains the condition of California's energy market, DWR's procurement objectives and its portfolio planning efforts.¹⁹ This evidence supports a just and reasonableness determination of long-term contract costs included within August 16, 2002 Determination.

When compared to the alternative of continuing to purchase large volumes of energy at excessive prices in the spot market during 2001, the long term contract costs included within the August 16, 2002 Determination are just and reasonable. The following facts provide substantial evidence to support a determination that the Department's costs were just and reasonable pursuant to Section 80110 of the Water Code and the Regulations: the dramatic reduction in spot

¹⁹ See e.g., Declaration of Ronald O. Nichols dated August 8, 2002 at paragraphs 4 through 43 (DWR II 05612-05640) and exhibits thereto — *History of DWR's Net Short Energy Procurement Process Under Long-Term Contract* (DWR II 05650-06245).

market prices during 2001 following DWR's contracting efforts,²⁰ the reduction in total costs as compared to prices that were experienced prior to contracting efforts undertaken by the Department,²¹ and projected prices and energy shortages absent actions taken by the Department.²² To maintain a reliable power supply, achieve lower prices in the market and halt the unsupportable continued drain on the State General Fund, the Department reasonably determined to move expeditiously to convert spot market purchases in an explosive market into longer-term bilateral contracts.²³

(iii). Location at Which Power is Received

Meehan's Declaration asserts that DWR purchased too much power in Southern California and that transmission constraints prevented use of this power to serve demand in Northern California.²⁴ However, the administrative record relating to the August 16, 2002 Determination demonstrates that the net short analysis and modeling efforts undertaken in

²⁰ See e.g., Declaration of Ronald O. Nichols dated August 8, 2002 at paragraphs 71 through 72 (DWR II 05612-05640). See also e.g., California Department of Water Resources Activities and Expenditures Report Quarter Ended June 30, 2001 (Sacramento Superior Court Case No. 01CS01200; Index of Quasi Legislative Record of Revenue Requirement Reasonableness Determination ("DWR I") 05261-05281).

²¹ Memorandum dated December 10, 2001 from the Department of Water Resources to Mary D. Nichols regarding Department of Water Resources' Response to the State Auditor's Draft Report. Declaration of Ronald O. Nichols dated August 8, 2002 at paragraph 39 (DWR II 05612-05640) and Exhibit 12 thereto—*History of DWR's Net Short Energy Procurement Process Under Long-Term Contract* (DWR II 05851-05853).

²² See e.g., Declaration of Ronald O. Nichols dated August 8, 2002 at paragraph 7 (DWR II 05612-05640).

²³ Memorandum dated December 10, 2001 from the Department of Water Resources to Mary D. Nichols regarding Department of Water Resources' Response to the State Auditor's Draft Report. (DWR II 03143-03162).

²⁴ Meehan Declaration at p. 9:10-21.

support of contracting efforts showed a need for power in Southern California.²⁵ In addition, there was evidence that grid expansions were planned in the near future, which would allow power delivered in Southern California to serve Northern California. (*See e.g.*, letter from Transmission Agency of Northern California (“TANC”) to Governor Gray Davis dated April 9, 2001, which states that “TANC . . . was planning to complete Path 15 upgrades by late 2002 and we were on track to do so” before Governor elected not to sign an Executive Order providing funding.)²⁶ Also, in March 2001, the CPUC requested that the utilities undertake certain steps to improve congestion on the transmission system²⁷ and PG&E was directed to file an application for a Certificate of Convenience and Necessity to perform upgrades to Path 15, which would permit use of power delivered to Southern California to serve load in Northern California.²⁸ Meehan references the Second State Auditor’s Report released on April 2, 2003 in support of his argument that DWR should not have relied on possible transmission upgrades to

²⁵ *See*, February 7, 2001 Draft memo from Ron Nichols to David S. Freeman, Vikram Budhraj and Dick Ferreira Re: Initial Evaluation of CDWR RFB#2, Table 4 (DWR I, 03672-03680), which lists zonal estimated net short in 2001 and 2002 remaining after the PX block forwards and RFB1 award. *See also*, initial net short calculations by zone provided by CAISO as set forth in Exhibit 1 to Declaration of Ronald O. Nichols dated August 8, 2002; *History of DWR’s Net Short Energy Procurement Process Under Long-Term Contract* (DWR II, 05653-05659). *See also*, June 2001 – SP15 Chart 4 Draft Summary of Average Hourly Unmet Load and Contract Purchases (DWR I, 02654-02678).

²⁶ Letter from James H. Pope, Transmission Agency for Northern California to Governor Gray Davis dated April 9, 2001 Re: Path 15 Upgrade (DWR I, 04322-04323).

²⁷ CPUC Decision 01-03-077, Interim Opinion on Transmission Upgrades Needed for Summer 2001 (Phase 1), 2001 Cal. PUC LEXIS 226.

²⁸ Assigned Commissioner’s Ruling Regarding Path 15 Transmission Upgrade dated March 29, 2001 in Commission Investigation 00-11-001, *Order Instituting Investigation Into Implementation of Assembly Bill 970 Regarding the Identification of Electric Transmission and Distribution Constraints, Actions to Resolve Those Constraints, Actions to Resolve Those Constraints, and Related Matters Affecting the Reliability of Electric Supply*.

use power delivered in Southern California to serve Northern California load.²⁹ This Report was issued over seven (7) months after DWR reached its August 16, 2002 Determination and almost two years after DWR entered into the majority of its long-term contracts. The Report does not purport to reach its findings or recommendations taking into account solely the facts available to DWR at the time DWR's long-term contract decisions were made. As a result, the Report cannot be definitive with respect to whether DWR's long-term contracts are just and reasonable.

(iv). **Fit to Energy Need**

Meehan asserts that “[u]nder AB 1X and a traditional prudence review, DWR must analyze whether the contract supplies fit each aspect of the overall load profile.”³⁰ Meehan argues the absence of evidence in the administrative record explaining the location of power deliveries and criticisms contained within the April 2, 2003 State Auditor's Report prevent a finding that the costs set forth in the August 16, 2002 Determination are just and reasonable. DWR disagrees. As referenced above, the administrative record does contain substantial evidence supporting the Department's decisions to accept power deliveries at certain locations under DWR's contracts. Although DWR has considered the analysis performed by the State Auditor in the Report, it is for the reasons stated above. The Report is not and cannot be definitive with respect to whether the August 16, 2002 Determination is just and reasonable.

²⁹ Meehan Declaration at p. 9:18-21.

³⁰ Meehan Declaration at p. 9:23-24.

(v). **Analysis of Renegotiations**

Meehan argues that the administrative record does not contain evidence supporting the prudence of DWR's renegotiated contracts.³¹ He contends that DWR has not provided an analysis to support the reasonableness of costs of the renegotiated contracts. As the record demonstrates, DWR has renegotiated long-term energy contracts with input and acceptance from the Commission, the Office of the Governor, the Attorney General's Office, and the Electricity Oversight Board.³² The Department relied in part on the expertise of these organizations in renegotiating the contracts with specific goals in mind. These goals included, but were not limited to: (1) reduction of nondispatchable energy to shape supply to match energy demand; (2) shortening of contract terms to avoid purchases that sellers required but that were not vital to the state; (3) reduction of contract prices to reduce overall portfolio costs; (4) reduction of volumes of purchases in later years of contracts; (5) enhancement of the reliability of energy by improving contract terms; (6) positioning of contracts for possible assignment to other parties; (7) facilitation of contract administration by improving the Department's contractual rights; and (8) targeting of projected customer savings of at least 20 percent.³³ Each renegotiation was conducted within the framework that included the original terms of the contract and controversies relating to each contract. Copies of the renegotiated contracts as well as evidence

³¹ Meehan Declaration at p. 10.

³² See e.g. Declaration of Ronald O. Nichols dated August 8, 2002 at paragraph 88 (DWR II 05612-05640) and Exhibit 45 thereto – *History of DWR's Net Short Energy Procurement Process Under Long-Term Contract* (DWR II 06234-06242).

³³ *Id.*

concerning related controversies involving those contracts are contained within the administrative record.³⁴ DWR believes that the above-described goals and the context of each renegotiation must be considered when assessing the just and reasonableness of DWR's revenue requirements for a specific timeframe. The Department's approach, which relies on several factors, is consistent with the CPUC's assessment of renegotiated power purchase agreements that examine a variety of mechanisms to increase ratepayer benefits.³⁵

C. A Price Benchmark is Relevant to Assess Whether Costs Resulting From DWR Power Purchases Are Just and Reasonable

In his Declaration, Meehan argues that DWR's use of a price benchmark was arbitrary and does not substitute for a just and reasonableness review.³⁶ This price benchmark was one of many elements considered in DWR's procurement efforts and ultimately DWR's just and reasonable determination dated August 16, 2002.³⁷ In its procurement efforts, DWR relied on an average generation rate of the utilities in part to compare the utilities' current rates to prices in the California energy market during early 2001.³⁸ When compared to energy prices during the

³⁴ See e.g., Amended and Restated Power Purchase Agreements between the Department and various parties as well as settlement agreements and news releases involving renegotiated contracts (DWR II 02205-02746; DWR II 03604-03681; DWR II 03774-04151).

³⁵ See e.g., Re Biennial Resource Plan Update, Decision 94-05-018, 54 CPUC 2d 383; see also e.g., Re Biennial Resource Plan Update, Decision 93-01-048, 47 CPUC 2d, 772; Re Power Purchase Project Contracts Between Electric Utilities and Qualifying Facilities, Decision 88-10-032, 29 CPUC 2d 415.

³⁶ Meehan Declaration at pp. 10:25-11:8.

³⁷ Declaration of Ronald O. Nichols dated August 8, 2002 at paragraph 52 (DWR II 05612-05640) and Exhibit 26 thereto – *History of DWR's Net Short Energy Procurement Process Under Long-Term Contract* (DWR II 05851-05853). See also, August 16, 2002 Determination at pp. 44-62.

³⁸ See e.g., Declaration of Ronald O. Nichols dated August 8, 2002 at paragraph 54 (DWR II 05612-05640).

last half of January 2001 (\$300/MWh - \$450/MWh), the price benchmark upon which DWR relied (\$70/MWh) to assess its procurement activities was reasonable.³⁹

D. PG&E's Criticisms of Specific Transactions Are Not Well-Founded

Meehan's Declaration challenges two procurement transactions undertaken by DWR. The first involves the renegotiation of DWR's contract with GWF Energy LLC ("GWF").⁴⁰ In his Declaration, Meehan speculates about the benefits derived from this renegotiation and then alleges that he has not located any evidence in the administrative record supporting the just and reasonableness of this renegotiated contract. The amendment of this contract occurred on August 22, 2002, and the proposed amendments were not certain enough to be taken into account in the complex modeling of revenue and expense projections that is a necessary preliminary step to the determination of DWR's revenue requirements. For this reason, the Department has not considered Meehan's criticisms of the renegotiated GWF contract as part of this Reconsideration.

The second transaction involves a contract DWR entered with Calpine Energy Services L.P. ("Calpine") on June 11, 2001.⁴¹ Meehan concludes that the transaction with Calpine represents an expensive transaction relative to similar products available in the forward market at

³⁹ *Id.* at paragraphs 39 and 54. In a December 15, 2000 order, FERC "found that an average of historical utility embedded cost of generation would represent an appropriate benchmark for determining the prudence of forward contracts" (*See*, CPUC Decision 01-03-067 Finding of Fact 16, *citing* 93 FERC P. 61,294; 2001 Cal. PUC LEXIS 220) (DWR I 05480-05515.) CPUC Decision 01-03-067 cites FERC's figure of \$67.45/MWh as "an average" of historical utility embedded generation costs. *See*, CPUC Decision 01-03-067 Finding of Fact 17.

⁴⁰ Meehan Declaration at pp. 12:3-13:20.

⁴¹ *Id.* at pp 13:21-16:6.

the time the contract was executed. Meehan's price comparison is inappropriate. The Calpine contract provides for dispatchable power from new generation resources, including during peak periods when power supplies may be scarce. The power product was dispatchable capacity, callable for up to 4000 hours per year. DWR's scheduling rights provided for day-ahead scheduling, with 1000 of the hours callable on an intra-day basis. The cost of obtaining such option rights is reflected in the capacity payment for the product. Dispatchable capacity is a different product from a block of must-take energy. The December 20, 2001 Report of the Bureau of State Audits recognizes that the price of capacity is different from the price of energy:

Different power products have different lowest possible prices . . . Other factors affecting the price include the hours of the day and the months of the year the power is delivered and whether the buyer has the option to refuse the power if it is not needed . . .

In the 24-hour base-load product, the generator has no down time and thus recovers its investment as quickly as possible. With peaking power, however, the generator's plant stands idle until the buyer demands the power, and thus the price must be increased to reflect the time that the investment in the generator is simply on hold, waiting for the buyer to dispatch the power.

It is possible that acquiring a greater proportion of peak contracts [peaking capacity purchases]—which provide power for fewer hours per year—might ultimately represent the best means for minimizing overall electricity costs to consumers to the extent that these contracts would shield consumers from price spikes in spot markets during periods of peak demand.⁴²

⁴² California State Auditor's Report dated December 20, 2001: California Energy Markets: Pressures Have Eased, but Cost Risks Remain at pp. 72 and 39. (DWR II 04814-05076.)

Despite the criticisms of specific transactions set forth in Meehan's Declaration, the Department has concluded upon reconsideration that its August 16, 2002 Determination is just and reasonable based on the portfolio planning efforts and procurement strategy undertaken by DWR during the energy crisis, which is reflected throughout the administrative record.

E. Conclusion

Based on the Court's December 26, 2003 Ruling, the administrative record as of August 16, 2002, and the comments received during the reconsideration process, the Department hereby determines on reconsideration that the August 16, 2002 Determination is just and reasonable for all periods covered thereby.